

**COMMONWEALTH OF MASSACHUSETTS**  
**DEPARTMENT OF TELECOMMUNICATIONS AND ENERGY**

**DIRECT TESTIMONY OF**  
**JOSEPH S. WILLIAMS**

**On Behalf of**  
**VERIZON NEW ENGLAND INC.**  
**d/b/a VERIZON MASSACHUSETTS**

**In Support of**  
**TARIFF TRANSMITTAL NO. 06-49**

**JUNE 16, 2006**

## **TABLE OF CONTENTS**

<b>I. INTRODUCTION.....</b>	<b>1</b>
<b>II. PURPOSE OF TESTIMONY .....</b>	<b>2</b>
<b>III. BACKGROUND.....</b>	<b>3</b>
<b>IV. COST STUDY METHODOLOGY .....</b>	<b>7</b>
<b>V. COST STUDY CALCULATIONS .....</b>	<b>13</b>
<b>VI. STUDY RESULTS .....</b>	<b>13</b>

## **EXHIBITS**

Exhibit 1: Verizon MA Avoided Cost Study

Exhibit 2: Verizon MA Avoided Cost Study Methodology

1 I. INTRODUCTION

2

3 Q. PLEASE STATE YOUR NAME AND POSITION WITH VERIZON.

4 A. My name is Joseph Williams and my position is Specialist, Financial Planning &  
5 Analysis-Service Costs in the Verizon Finance Department. In that position, I am  
6 responsible for analyzing approximately \$40 billion in expenses to support Verizon's  
7 regulatory cost studies.

8

9 Q. WHAT IS YOUR EDUCATIONAL AND PROFESSIONAL BACKGROUND?

10 A. I am a graduate of the University of Kansas where I received a Bachelor of Science  
11 degree in Accounting and Business Administration. In addition, I am a Certified Public  
12 Accountant licensed in the state of Kansas.

13

14 I have been employed by Verizon for 17 years in various accounting, budgeting, and  
15 finance roles in both regulated and non-regulated business units. I began my career as a  
16 cost accountant with GTE Directories, now Verizon Information Services. I worked in  
17 the Budgets and Analysis departments of three business units where I performed annual  
18 budgets and monthly and quarterly forecasts and analyzed variances between actuals and  
19 forecasts. I also worked in New Business Development, where I prepared business cases  
20 and new business proposals. Prior to joining Verizon, I worked for a short time in public  
21 accounting as an auditor and in industry as a staff accountant.

## II. PURPOSE OF TESTIMONY

### Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. My testimony presents the methodology that Verizon New England Inc., d/b/a Verizon Massachusetts (“Verizon MA”) used to update the resale discounts that apply when Verizon MA’s retail telecommunications services are resold in Massachusetts by carriers pursuant to section 251(c)(4) of the Telecommunications Act of 1996 (“the Act”).

The Act established a method of market entry known as resale of Incumbent Local Exchange Carrier (“ILEC”) retail telecommunications services. Section 252(d)(3) of the Act requires ILECs to develop discounted retail rates adjusting for costs that “will be avoided by the local exchange carrier” when its services are offered at wholesale rather than retail.

Attached to my testimony, as Exhibit 1, is an avoided cost study calculated using year 2005 data. This exhibit identifies the costs Verizon MA actually avoids when making its retail telecommunications services available for resale in Massachusetts. Resale can be provided in two ways:

- 1) The reseller uses Verizon Operator Services and Directory Assistance (“OS/DA”), or
- 2) The reseller uses its own platform (or the platform of a third party other than Verizon) to provide OS/DA functions.

1 Based on the avoided cost study, the costs that Verizon MA actually avoids, when its  
2 retail telecommunications services are resold by wholesale carriers, result in the  
3 following resale discounts:

4 1) **11.94%** if the reseller uses Verizon OS/DA functions, and

5 2) **14.71%** if the reseller uses its own platform to provide OS/DA functions.  
6

7 Also attached to my testimony is Exhibit 2, which describes in detail the methodology  
8 used to calculate the wholesale discount.  
9

## 10 **II. BACKGROUND**

### 11 12 **Q. WHAT IS VERIZON MA'S CURRENT RESALE DISCOUNT IN** 13 **MASSACHUSETTS?**

14 A. Ten years ago, the Department set discount rates of 24.99 percent if the reseller uses  
15 Verizon MA's OS/DA functions and 29.47 percent if the reseller uses its own or another  
16 provider's OS/DA platform pursuant to its Phase II orders in the Consolidated  
17 Arbitrations.<sup>1</sup>

---

<sup>1</sup> Consolidated Petitions of New England Telephone and Telegraph Company d/b/a NYNEX, Teleport Communications Group, Inc., Brooks Fiber Communications, AT&T Communications of New England, Inc., MCI Communications Company, and Sprint Communications Company, L.P., pursuant to Section 252(b) of the Telecommunications Act of 1996, for arbitration of interconnection agreements between NYNEX and the aforementioned companies, D.P.U. 96-73/74, 96-75, 96-80/81, 96-83, 96-94 – Phase II Orders issued December 3, 1996 and February 5, 1997.

1   **Q.   DID YOU USE THE SAME METHODOLOGY IN THE NEW AVOIDED COST**  
2       **STUDY ATTACHED TO YOUR TESTIMONY AS WAS USED TO SUPPORT**  
3       **THE RESALE RATE CURRENTLY IN EFFECT?**

4   A.   No. The study that Verizon MA presented in 1996 was designed to comply with the  
5       methodology prescribed by the FCC in its August 18, 1996 *Local Competition Order*,  
6       and codified in 47 CFR § 51.607 and 609. The FCC’s methodology calculated wholesale  
7       discount rates based on the costs that were *potentially* avoidable by Verizon MA under a  
8       hypothetical construct in which Verizon completely exited its retail businesses and  
9       became a 100-percent wholesale company in Massachusetts.

10  
11       The FCC’s avoidable cost methodology for determining resale discounts was invalidated  
12       by the United States Court of Appeals for the Eighth Circuit in its July, 2000 decision in  
13       *Iowa Utilities Board v. FCC*, 213 F.3d 744 (8th Cir. 2000), *aff’d in part and rev’d in part*  
14       *on other grounds sub nom. Verizon Comms. Inc. v. FCC*, 535 U.S. 467 (2002).  
15       Specifically, the Eighth Circuit ruled that the Act provided a clear standard in § 252(d)(3)  
16       for determining the wholesale discounts. The Court stated:

17               The language of the statute is clear. Wholesale rates shall exclude “costs  
18               that will be avoided by the local exchange carrier.” ... The plain meaning  
19               of the statute is that costs that are actually avoided, not those that could be  
20               or might be avoided, should be excluded from the wholesale rates.  
21

22       The Court also addressed the FCC’s hypothetical construct of a 100 percent wholesale  
23       company, noting,

24               The statute recognizes that the ILEC will itself remain a retailer of  
25               telephone service with its own continuing costs of providing that retail  
26               telephone service. ... Under the statute as it is written, it is only those  
27               continuing costs of providing retail telephone service which will be

1           avoided by selling to the competitor the services it requests which are to  
2           be excluded.

3  
4           Consequently, the attached avoided cost study follows the Eighth Circuit's ruling  
5           and excludes from the wholesale rates those costs that "will be avoided"<sup>2</sup> – the  
6           exact language of the Act – when services are offered for resale.

7  
8   **Q.    HAVE ANY OTHER STATE COMMISSIONS SET RESALE DISCOUNTS FOR**  
9   **VERIZON COMPANIES CONSIDERING THE ACT'S LEGAL STANDARD**  
10   **UPHELD BY THE SUPREME COURT?**

11   A.    Yes.

- 12       •   The FCC's Wireline Competition Bureau, in an interconnection agreement arbitration  
13       conducted during a period that the Commonwealth of Virginia refused to hear such  
14       matters, used the "actual avoided costs" standard to determine a resale discount for  
15       Verizon Virginia.<sup>3</sup> The Bureau ordered rates of 13.11 percent if the reseller uses  
16       Verizon's Operator Services/Directory Assistance and 14.74 percent if the reseller does  
17       not.
- 18       •   The District of Columbia Public Service Commission recently set resale discounts under  
19       the standard provided by the Eighth Circuit.<sup>4</sup> The Commission adopted a resale discount

---

<sup>2</sup> Although the U.S. Supreme Court ultimately reviewed part of that Eighth Circuit Order, certiorari was not granted on this point. *See Iowa Utils. II, 121 S. Ct. 878 (2001)* (granting certiorari on three issues), and the resale discount aspect of the Eighth Circuit's decision remains controlling.

<sup>3</sup> Before the Federal Communications Commission, Memorandum Opinion and Order DA 03-2738, adopted August 28, 2003, para. 673.

<sup>4</sup> Formal Case No. 962, *In the Matter of the Implementation of the District of Columbia Telecommunications Competition Act of 1996 and Implementation of the Telecommunications Competition Act of 1996*, Order No. 12610, December 6, 2002, para. 67, and re-affirmed in *Partial Order On Reconsideration*, April 3, 2003, Order No. 12695, paras. 22 – 48.

1 rate of 12.72 percent if the reseller uses Verizon's Operator Services and 14.79 percent if  
2 the reseller does not.

- 3 • In October 2004, the Pennsylvania Public Utility Commission issued a Settlement  
4 Stipulation<sup>5</sup> setting Verizon's statewide wholesale rate for the resale of its  
5 telecommunications services. The effective rate, not including Pennsylvania's 5% Gross  
6 Receipts Tax, is 13.34% for resellers using Verizon's Operator Services and 17.00% for  
7 resellers choosing not to use Verizon's Operator Services. The stipulated rates used  
8 Verizon's Avoided Cost study as a basis for the rate.
- 9 • In May 2006, the Illinois Commerce Commission ordered a uniform wholesale discount  
10 rate of 14.5% based on calculations supported by Verizon and Commission Staff,  
11 conforming to the avoided cost methodology.<sup>6</sup>

12  
13 **Q. HOW DO VERIZON'S AVOIDED COSTS FUNCTIONS COMPARE WITH THE**  
14 **ACT'S DEFINITION?**

15 A. § 252(d)(3) of the Act states:

16 For the purposes of section 251(c)(4), a State commission shall determine  
17 wholesale rates on the basis of retail rates charged to subscribers for the  
18 telecommunications services requested, excluding the portion thereof  
19 attributable to any marketing, billing, collection, and other costs that will  
20 be avoided by the local exchange carrier.  
21

22 The following chart displays how Verizon aligns specific avoided cost functions with the

---

<sup>5</sup> Before the Pennsylvania Public Utility Commission, Settlement Stipulation, Docket No. R-0038516, *Wholesale Rate for Resale of Telecommunications Services Provided By Verizon Pennsylvania Inc. and Verizon North Inc.*, Section II., para. 8.

<sup>6</sup> Before the Illinois Commerce Commission, Formal Case No. 00-0812, *Petition Seeking Approval of Cost Studies for Unbundled Network Elements, Avoided Costs and Intrastate Switched Access Services*, Order May 3, 2006, Section III., para. 5.



1 broad language of the Act:

<b>1996 Telecommunications Act Avoided Cost Categories</b>	<b>Corresponding Verizon Avoided Cost Functions</b>
<b>Other</b>	<b>Customer Repair Service Bureau (Partial Account 6533)</b>
<b>Marketing</b>	<b>Product/Market Management (Partial Account 6611)</b>
<b>Marketing</b>	<b>Marketing/Account Executive Sales (Partial Account 6612)</b>
<b>Other</b>	<b>Customer Servicing (Partial Account 6623)</b>
<b>Billing and Collection</b>	<b>Billing Operations (Partial Account 6623)</b>

2 **IV. COST STUDY METHODOLOGY**

3

4 **Q. PLEASE DESCRIBE THE METHODOLOGY THAT YOU USED TO**

5 **DETERMINE VERIZON MA'S ACTUAL AVOIDED COST, WHICH WAS**

6 **THEN USED TO CALCULATE THE RESALE DISCOUNT RATE.**

7 A. Verizon MA expense data for calendar year 2005 is the starting point in determining its

8 avoided costs. Detailed studies were conducted to determine the marketing, billing,

9 collection, and other costs that will be avoided by Verizon MA when its retail

10 telecommunications services are resold to wholesale carriers.

1 **Q. WHY IS IT APPROPRIATE TO USE SEPARATED COSTS FOR**  
2 **DETERMINING THE RESALE DISCOUNT?**

3 **A.** Interstate services and non-regulated services are not subject to resale at a discounted  
4 rate.

5 Verizon MA's expenses are allocated between the state and interstate jurisdiction through  
6 the separations process. Intrastate expenses are recovered via intrastate charges,  
7 consisting generally of retail charges and wholesale charges. Interstate expenses are  
8 recovered through interstate charges, which generally consist of Switched Access  
9 charges, Special Access Charges, and End User Common Line (EUCL) charges. The  
10 resale discount that will apply to intrastate regulated services should be calculated using  
11 the expenses that are recovered in Verizon MA's intrastate regulated rates.

12  
13 **Q. IN WHICH ACCOUNTS DOES VERIZON MA AVOID EXPENSES?**

14 **A.** Verizon MA avoids expenses in certain accounts associated with selling, providing,  
15 managing and maintaining customer services. Verizon MA avoids certain of the  
16 expenses in the following USOA accounts:

- 17 • Account 6533 – Testing (Customer Repair Service Bureau)
- 18 • Account 6611 – Product/Market Management
- 19 • Account 6612 – Sales
- 20 • Account 6623 – Customer Servicing & Billing

21 Verizon MA also avoids all of the expenses in the following accounts if the reseller  
22 chooses not to use Verizon MA's operator services and directory assistance platform:

- 23 • Account 6621 – Operator Services
- 24 • Account 6622 – Number Services

- Account 6220 – Operator Systems

**Q. HOW DOES VERIZON MA TREAT NETWORK EXPENSES?**

A. For the most part, Verizon MA does not avoid any network expenses when its intrastate services are resold, except for expenses in accounts associated with “customer facing” activities or that are primarily associated with dealing with customers rather than maintaining and operating the network. Specifically, a portion of the Testing Expense – Account 6533 – is avoided because it involves trouble-report activities performed for Verizon’s retail customers. (See Exhibit 1, WP3, Lines 9 – 43, Column I, which shows which network and non-network accounts are avoided or not avoided). No other network operations or network support expenses in these accounts are avoided. (See Exhibit 2, Section 2a.)

**Q. WHAT EXPENSES ARE AVOIDED IN ACCOUNT 6611 - PRODUCT/MARKET MANAGEMENT?**

A. Account 6611 includes expenses assigned to Product Management and Market Management. Product Management expenses are not avoided since they must be performed whether the customer is a reseller or end-user. Whether a product is sold as retail or resale, the product must be fully designed, developed, and delivered in order to be available to any customer, wholesale or retail.

Market Management functional expenses in Account 6611 are 100 percent avoided since these expenses are sensitive to the volume of customers. (See Exhibit 2, Section 2b).

1 **Q. WHAT EXPENSES ARE AVOIDED IN ACCOUNT 6612 - SALES?**

2 A. The portion of Account 6612 expenses identified as avoided was based on a Verizon-  
3 wide study of sales expense by the appropriate Verizon Lines of Business (LOB).  
4 Expenses in Account 6612 assigned to the Retail and Enterprise LOB's are avoided.  
5 (See Exhibit 2, Section 2c).

6  
7 **Q. HOW DID YOU TREAT EXPENSES IN ACCOUNTS 6621 – CALL**  
8 **COMPLETION, 6622 – NUMBER SERVICES, AND 6220 – OPERATOR**  
9 **SYSTEMS?**

10 A. These expenses are avoided only where a reseller does not use Verizon's operators and  
11 systems, in which case the expenses associated with Call Completion/Number Services  
12 and Operator Systems are included as avoided costs (the numerator) in developing the  
13 avoided cost discount. If the reseller is using its own (or a third party's) operator services  
14 platform, these expenses are avoided.

15  
16 **Q. WHAT EXPENSES ARE AVOIDED IN ACCOUNT 6623 – CUSTOMER**  
17 **SERVICES AND BILLING OPERATIONS?**

18 A. Account 6623 includes both Customer Services and Billing Operations (billing and  
19 payment processing). The amount of Customer Services expense avoided is based on  
20 sub-account detail (See Exhibit 2, Section 2d). The amount of Billing Operations  
21 expense avoided is determined from a special study. (See Exhibit 2, Section 2e).

1   **Q.   DOES VERIZON AVOID UNCOLLECTIBLE EXPENSE?**

2   A.   Yes, Verizon's retail uncollectible expenses are avoided when its telecommunications  
3       services are offered for resale since the Reseller bears the risk of collection from the end  
4       user.   However, Verizon experiences significant wholesale uncollectible expenses.  
5       Therefore, although retail uncollectible expense is avoided, additional expense for  
6       wholesale uncollectibles must be considered.   While Verizon's wholesale uncollectible  
7       rate is greater than the retail uncollectible rate, Verizon conservatively chose to exclude  
8       uncollectible expense from the avoided cost calculation, rather than show wholesale  
9       uncollectibles as an additional cost incurred when Verizon services are resold.

10  
11   **Q.   HAVE YOU IDENTIFIED ALL AFFECTED ACCOUNTS WHERE VERIZON**  
12       **ACTUALLY AVOIDS EXPENSES?**

13   A.   Yes.   The applicable avoided cost standard prescribes that Verizon MA include only  
14       costs that are actually avoided when calculating the resale discount.   Verizon MA has  
15       listed all of those accounts here and in Exhibits 1 and 2.   Expenses that do not meet the  
16       avoided cost standard are not included in the resale discount calculation.   Such expenses  
17       are not actually avoided when products are offered for resale to wholesale carriers.

18       Included in the expenses not avoided are:

- 19           •   61XX General Support Expenses
- 20           •   62XX – 65XX Network Operations Expense (except for the Customer Repair  
21               Service Bureau portion of 6533)
- 22           •   661300 – Product Advertising
- 23           •   67XX – General and Administrative Expenses

1   **Q.     TURNING NOW TO THE DENOMINATOR IN THE CALCULATIONS, WHAT**  
2       **ARE THE APPROPRIATE REVENUES TO USE IN THE CALCULATION OF**  
3       **THE RESALE DISCOUNT RATES?**

4   A.   Verizon MA includes revenues for all intrastate retail telecommunications services that  
5       must be offered for resale at wholesale rates. (See Exhibit 2, Part 3). Revenues excluded  
6       from the denominator are:

7       1.    Non-retail revenues – Because the resale discount applies to the tariffed retail  
8           rates, non-retail revenues are excluded from the denominator, *e.g.*, rent revenue  
9           for collocation or unbundled network elements.

10      2.   Access Revenues – These services are not subject to the resale discount since they  
11         are not in the retail tariffs and by definition are not available directly to the  
12         public. Under the Act, “The term ‘telecommunications service’ means the  
13         offering of telecommunications for a fee directly to the public, or to such classes  
14         of users as to be effectively available directly to the public, regardless of the  
15         facilities used.”

16         The FCC’s *First Report and Order on Local Competition* in paragraph 980 states  
17         that the Inter-exchange Carrier must “purchase access services from incumbent  
18         LECs outside of the resale framework of 251(c)(4), through the existing interstate  
19         access tariffs”.

20      3.   Non-regulated services revenues (*e.g.*, Third Party Billing, Inside Wire  
21         Maintenance) – These revenues, as identified in FCC Part 64, Separation of  
22         Regulated and Non-regulated Costs, are associated with services that are not  
23         tariffed communications services.

1 4. Interstate revenues – These have been removed since the resale discount only  
2 applies to Intrastate services.  
3

#### 4 **V. COST STUDY CALCULATIONS**

5

6 **Q. HAVE YOU PROVIDED THE STEP-BY-STEP CALCULATIONS CONTAINED**  
7 **IN THE COST STUDY WORKSHEETS?**

8 A. Yes. Exhibit 1 contains the actual avoided costs and resale discount calculations.  
9 Exhibit 2 contains detailed descriptions of the cost study calculations.  
10

#### 11 **VI. STUDY RESULTS**

12

13 **Q. IN SUMMARY, WHAT ARE THE RESALE DISCOUNT RATES THAT ARE**  
14 **APPROPRIATE FOR VERIZON MA?**

15 A. As mentioned earlier, I developed two discounts - a discount for resellers who use  
16 Verizon MA's Operator Services (for both Call Completion and Directory Assistance  
17 Calls), and a discount for resellers who provide their own Operator Services. The  
18 discounts are displayed in Exhibit 1, WP1, Line 19.

19 Resale Discount Assuming Reseller Uses Verizon OS/DA **11.94%**

20 Resale Discount Assuming Reseller Uses Own or Third Party OS/DA **14.71%**  
21

22 **Q. DOES THIS CONCLUDE YOUR TESTIMONY?**

23 A. Yes.